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SUBJECT: MEXICAN CREDIT CRUNCH AFFECTING INTEREST RATES, CREDIT AVAILABILITY AND SMES

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¶1. (SBU) Summary. Although the Mexican financial system remains well capitalized, credit has become more expensive and more difficult to obtain for certain sectors such as for car purchases and small and medium sized enterprises. Our contacts all agree that the Mexican financial system will not suffer a crisis on the scale of the 1994 `tequila crisis', but most think that banks are reevaluating credit lines and restricting credit access. On balance, we expect that credit will continue to tighten as the impact of the U.S. recession and financial woes affect the real economy in Northern Mexico. End Summary.

Mexican Financial System Remains Well Capitalized

¶2. (SBU) Our contacts agree that the Mexican financial system entered into the global crisis in good shape. Jorge Vasquez of Harbor Consultants pointed out that the latest statistics show that Mexican banks are well capitalized, with 15% reserves, above the US banks 10-13%, and well above international requirements (see reftel A). Domestic banks pulled back after the 1994 crisis, and their vanilla mortgage products and lack of financial penetration in the market have protected them in this downturn. Mexican banks did not make exotic home mortgage loans, and the level of Mexican consumer credit cards is only 6%, compared to 80% in the U.S. However, Mexican banks are over 80% foreign owned, thus connecting them to world financial markets. Our interlocutors pointed out that unlike prior crises, which grew from poor Mexican macroeconomic policies, this crisis is imported from abroad. All of our contacts agreed that the current crisis will not resemble the 1994 catastrophic crisis, which sharply restricted credit availability and painfully reduced living standards.

¶3. (SBU) Despite the financial systems overall strength, global financial conditions have increased the cost of credit and tightened its supply in Mexico. As noted earlier, since over 80% of domestic banking assets are controlled by foreign banks, the Mexican subsidiaries have had to withdraw capital from Mexico to cover losses at home. In addition, local business consultant Robert Chandler pointed out three other factors reducing the supply of credit in Mexico. Although Mexican banks did not engage in the same excesses as in the U.S., they still have aggressively extended credit for cars and consumer purchases, and the delinquency rates of these loans have climbed sharply. Mexico does not have any usury laws, so

consumer credits cards can have effective rates, including fees, commissions and late charges, of 100%, so if a consumer falls behind they can never catch up with their payments. In addition, banks aggressively marketed their consumer credit cards, but there was no effective way to measure the consumers' overall indebtedness, so a marginal credit applicant could obtain multiple credit cards. In addition, Mexico's managed pension funds, called AFORES, have suffered losses since April 2008, mirroring the stock market, further reducing the Mexican stock of capital. Finally, according to Chandler, foreign investors are pulling money out of Mexico. Although Mexico still has an attractive yield interest rate spread compared to the United States, foreign investors have made their `flight to quality' to dollar denominated investments. In addition, despite the investment spread, foreign investors have been burned by the market devaluation of the Mexican peso, which has fallen significantly against the dollar, thus reducing the value of their investments. Nevertheless, several financial consultants told us that Mexican investors were maintaining their investments in pesos, and were not fleeing to the safety of dollars as they had in prior crises.

Consequences of the Credit Crunch

¶4. (U) All observers agree that Mexican credit has become more expensive and loan delinquency rates have increased. Vasquez noted that mortgage interest rates have climbed 2-3%, and consumer credit cards interest rates had risen 8%. Credit delinquency is also up. According to press reports, October loan delinquency rates have risen to 8.1% for credit cards, 3.4% for mortgages and 1.56% for business loans. Another report claims that 9.9% of consumers are behind in their credit card payments.

¶5. (SBU) Most of our contacts think that credit access has become more restricted. Chandler commented that new business projects are nearly suspended, a representative of a U.S. company stated that business credit has almost dried up and Vasquez said that Banks are reducing credit lines and re-evaluating existing credit. The business association CAINTRA conducted a survey of 300 members, and found that 40% of their members who had commercial bank credits found that the banks were demanding more guarantees and reducing their credit lines in half. An additional 30% said that the Mexican Development Bank Nacional Financiera (Nafin) was cutting back their access to credit. CAINTRA claimed publicly that 120 businesses would be forced to close in Nuevo Leon due to lack of credit. In contrast, Roberto Guerra of the Fitch Credit rating company believed that credit and commercial paper were still fully available for solid companies, albeit at higher interest rates. Similarly, Amcham executive director Roberto Cavazos was blithely optimistic, stating that he did not believe that credit access was a problem for Amcham member companies (which run the gamut of small, medium, and large).

¶6. (SBU) There are several areas which are clearly affected, such as financing for car purchases. Katia Calderon, the local head of GMAC financing, reported that there was little liquidity to permit consumers to purchase cars, which has helped drive down car sales by 20% in Mexico. Calderon was also upset that the Government of Mexico did not seem to understand the seriousness of the problem and had done nothing to help the sector. In contrast, the governments of Brazil and Spain had programs to assist consumer liquidity.

¶7. (SBU) The impact of the credit crunch appears to particularly have hit Small and Medium Sized Enterprises (SMEs). Sergio Mata, head of the financing committee at CAINTRA, emphasized to Econoff that 70% of financing for formal SME businesses comes from credits from suppliers, usually against their accounts receivable. The suppliers have made their terms stricter. For example, before the suppliers would provide credit up to 90% of the value of the accounts receivables, but now it is only 70%. Mata also reports that banks are re-evaluating SME loans and reducing credit lines. For example, CAINTRA surveyed 2,000 SMEs, and found that very few had received new bank loans. Mata also said that Nafin loan guarantees were not helping many SMEs because the commercial banks were not accepting the Nafin guarantees and were still looking for more collateral from the borrower.

¶8. (SBU) Felix Tejada of the Alles Real Estate group noted while companies were consolidating operations to save money, they were not leaving Mexico. Tejada reports that companies with sufficient cash flow are receiving financing, which they are using to cut costs by consolidating operations in one location, for example in Mexico City, Monterrey or Tijuana. Tejada was encouraged that these companies seem committed to remaining in Mexico.

¶9. (SBU) Comment. Despite several voices of optimism, we believe that the credit crunch is real and getting worse. One Amcham member commented that Mexico today is in the same position as the United States was several months ago, before the financial crisis began to significantly impact the real economy. End Comment.
WILLIAMSON